Competition and Combination

By B. M. Anderson, Jr.
New York City

THE pressure of war emergencies has brought a large part of the world to accept an extreme public control of business and economic activities. So far has this gone in some places and in some industries that it is difficult to distinguish it from state socialism. Public control, involving combination and concentration and systematic organization of industries, has proved more effective during the war than most of us would have anticipated. The problem is now presented as to whether we shall go back to the old system of competitive free enterprise so essentially congenial to English and American tradition and so well tested in the marvelous development of economic life in England and the United States before the war, or whether, as a result of our war-time experience, we shall seek to preserve a large part of the organization built up by the war. There is a strong sentiment for continuance of the government control of the railroads, and there is a revival of sentiment in favor of large scale industrial combinations subject to government regulation. There is no considerable body of sentiment in favor of the old unregulated monopolistic trusts, but there is considerable sentiment in favor of industrial combinations which shall eliminate competition, and which shall be prevented from injuring the public through regulation by such a body as the Federal Trade Commission. It is worth while, therefore, to reëxamine the factors involved in the competitive system, and to see whether the arguments, which English and American economists have commonly offered in favor of competition, retain their validity under present day conditions.

Business Profits and Social Welfare

It will help to get the matter before us if we consider some of the claims made by the defenders of unregulated monopoly at an earlier period in our history, and particularly the claims presented in the once popular prospectuses of the trust promoters. We shall analyze these claims from two points of view; (a) From the stand-

point of the men inside the combination, and (b) from the general social point of view, or the point of view of the country as a whole. In general, under competitive conditions, whatever makes for business profits makes also for the welfare of the country. The successful business man, who is playing the game fairly, is successful because he creates wealth, and creates wealth more efficiently than other men can do it. Where we have monopolistic combination it still remains true at points that business profits are a mark of social service, but at other points this is clearly not the case. In what follows we shall undertake to see how far the interests of the monopolistic combination and the general public are alike or are divergent.

In considering this, we must distinguish sharply the advantages of large scale production from those of combination as such—technical bigness in a given plant is one thing, while the financial consolidation of many big plants is a different thing. A list of the advantages claimed by the trust "promoter" follows:

1. Power over prices; power to raise prices and to keep them steady.

2. Power over labor; power to control unions and to prevent strikes.

3. Power over jobbers and other middlemen; power to compel them to pay promptly; power to refuse to allow their claims for shortages and damaged goods, etc.

4. Power over the producer of raw material (sometimes stated simply as the ability to buy more cheaply because buying in larger quantities).

I assume that little question will be raised but that virtually all these advantages of combination are socially disadvantageous, and it may be assumed that in any new movement of combination under government regulation, the effort will be made to curb the power of combinations at these points. Some question may be raised as to whether the monopolist's power to keep prices steady is a bad thing, although clearly the power to hold up prices in a period of depression is undesirable, since one important factor in relieving depression is such a decline in prices that new buying is called forth.

Concession must be made, too, to the principle that there is

social economy in wholesale buying (item 4 in the list) in so far as it comes from eliminating unnecessary handling of the goods. Of course, where it comes through oppression of the sellers, it is evil. The advantage of wholesale buying is one that does not grow indefinitely. It makes large scale production more advantageous than small scale production, but after a business unit has become large enough to have efficient management and to make purchases on a considerable scale, it does not gain much by further growth, so far as cheap buying is concerned.

To resume the list:

> **5. The big firm can utilize by-products which are wasted by the small producer.**

But this is merely an argument for large scale production. No limit should be placed on the size of the individual plant; but this does not require financial consolidation of many big plants.

> **6. There is a gain from the integration of different stages in the same line, as, for example, where by combining different stages in the manufacture of steel you are able to put the metal through several processes without allowing it to get cold.**

But, pretty obviously, this is again merely an argument for technical bigness of a single organization in a single locality. It means nothing as an argument for combining different plants in different localities. It is, further, in no sense an argument for the combination of *competing* producers in the *same* stage of production.

> **7. Where you have several competing firms, each will have a few patents covering certain parts of the process of manufacture, while the others will have patents covering other parts of the process. None will be able to use the best methods at all stages of production because of the monopoly by others on the patented processes. If they combine, however, then all plants can use all of the patents.**

Plausible at first, this argument, upon analysis, presents curious features. It says in effect: "Monopoly in patents is a bad thing; let us remedy it by getting a monopoly of the whole business!" The logical conclusion of the argument would be the

throwing open of all patents to all producers. It is an argument against the original theory of the patent itself. A patent is useful to its owner only in so far as it gives him a *differential* advantage over rivals who are trying to perform similar services. It presupposes the possibility of competition. If all the producers in a given line are in combination, then the idea, unpatented, would be just as useful as if it were patented. The theory of the patent is, of course, to stimulate invention by giving the inventor a chance at profits from which others are excluded as compensation to him for his risk and trouble as inventor.

Conceding, however, the desirability of having all the producers in a given line make use of all the patents, it by no means follows that combination among them is necessary. The plan of throwing all patents open to all who care to use them upon the payment of a royalty (the same rate to all) to the inventor, would accomplish the end in view equally well, and would leave the spur of competition as a means of forcing into immediate use all really useful inventions. It would further assure the inventor of a real reward when his patent is put into use.

8. Competing firms, it is argued, have large advertising expenses which are counted as part of cost of production, and raise the prices of goods. A monopoly can dispense with much of this advertising. Tremendous figures in dollars and cents are given in connection with this argument, and the implication of a tremendous social waste is seemingly taken for granted.

It may be true that monopolies have to advertise less than competitive firms do and so can save a considerable expense. It is not clearly in evidence, however, that monopolies have refrained from heavy advertising. But granting the theory, it by no means follows that society at large would be saved the sums involved. What competition takes with one hand, it restores with the other. The consumer pays more for the advertised goods; granted for the sake of argument. But he also pays vastly less for newspapers, periodicals, etc. Competition among publishers in expanding their circulations so as to get advertising has compelled them so to reduce the subscription rates to their papers and periodicals that the purchaser often gets them for less than the cost of the paper on which they are printed. The social cost of ad-

vertising is simply the labor of type-setters, the labor of advertising writers, the paper and ink used in printing advertisements, etc.—a vastly smaller cost than the amounts paid for advertising would indicate. And the educational gain that comes from such a wealth of cheap reading matter—making all concessions that any one demands as to the cheap *quality* of much of the reading matter!—is incalculable. Besides, the advertising itself is a real social gain. It stimulates *wants*—and wants are the steam that keeps social progress going. It is as much in the multiplicity and insistence of his wants as in anything else that civilized man is superior to the savage. Advertising, moreover, communicates information. Purchasers and producers do not get together automatically. There is no way by which marketing can be prevented from being an expensive and a difficult matter, requiring the efforts of great numbers of men and the anxious thought and attention of the ablest minds in the industrial world.

9. Combination enables a business to discharge numerous traveling salesmen, and impressive figures have been offered to show how much is thereby saved.

That the combination does save thereby is for the argument's sake admitted, and that there is some social saving, after the discharged salesmen get to work at something else, is also admitted. But it is denied that the social saving is *net* by any means. For the traveling salesman is a dynamic social agent. He spreads ideas; he keeps the trade up to standards; he aids in making the country socially homogeneous; he breaks up provincialism and traditional methods of doing business. He is of special service to young business men in small communities. Moreover, personal solicitation, however costly, is very necessary in many lines of business. This has been strikingly illustrated in the experience of state insurance in Wisconsin.

10. Combinations can save cross-freights, which under a competitive system are likely to occur.

Now it is difficult to determine the extent to which such cross shipments have taken place under the competitive system. The presumption is, of course, that if a New York firm really has goods just as good and cheap as a Chicago firm, it can, with the freight item in its favor, undersell the Chicago firm in the local market,

But the argument that follows applies, whether the amount of cross-freights is large or small. The saving on this point may be big in dollars and cents to the combination; socially considered, it is subject to a substantial discount. The reason is that the railroad business is a business subject to the "law of diminishing costs." Given the expensive roadbed, given the terminals, given the train crews and rolling stock, given the office organization, there is a huge expense, a fixed expense, whether the transportation business done is large or small. A train may run full almost as cheaply as empty. A track may be used twenty times a day almost as cheaply as once a day. Extra business does increase the *variable* expense, but it does not increase that tremendous item in the railroad's bookkeeping, the fixed expense.

This counter argument is, of course, not applicable in a period of war, when the railroads are working at maximum capacity, nor is it applicable in a section where population is dense and railroads normally run at something like full capacity. But in normal times for the great part of the country it is a valid counter argument. The net saving from elimination of cross-freights is only the *variable* expense of the transportation concerned, and not the whole of the freight charges involved.

11. The combination need make no extensions of credit and so gets along with less capital than the separate firms require, thus saving interest.

True, but on the other hand, the jobbers and retailers must then use *more* capital, paying interest for it often at higher rates than the manufacturer charges, so that an even larger interest charge enters into the price that the consumer pays, and there is no social saving of capital.

In general conclusion on this point, it may be said that many of the gains of the combination are clearly socially disadvantageous, representing merely subtractions from the incomes of other elements of society in exact proportion to the monopoly's gain; that many others, in so far as legitimate, come not from combination as such, but merely from large scale production in the single plant; that of those gains which come directly from combination through the elimination of "competitive wastes," virtually all are subject to a substantial discount before they can be reckoned as social gains, and many are socially illusory. Further,

as against these and all similar arguments, are to be put the familiar doctrines of English and American economics as to the stimulating effect of competition, the great mainspring of economic progress, and the fact that, other things equal, size is a handicap, leading to unwieldiness and red tape.

In the argument that has preceded, it has been provisionally conceded that the claims of the trust promoters as to the business gains of combination are valid. But this concession need not be made. It is certainly undemonstrated that any combination has been successful because of its economies alone. The successful trusts have been successful primarily through monopoly which they have secured by means other than the economies of combination, and there are numerous wrecks in the history of trusts in cases where through failure to get monopoly the big combine found itself unable to hold its own with less clumsy competitors. Professor E. S. Meade of the University of Pennsylvania maintains vigorously in the April, 1912, number of the *Journal of Political Economy* that from the angle of business profit itself, the old trust did not make good, and offers detailed statistical evidence for his view.

On the whole, therefore, we conclude that while combination of a technical sort, the combination which makes for large scale production, the combination which makes possible the full utilization of by-products or other technical advantages, may be trusted to go as far as business men care to take it, the public welfare is best served by an avoidance of the financial combination of competing plants, especially when located in different cities, which are engaged in the same stage of production of a given commodity.

FINANCIAL COMBINATION OF WEAK BARGAINERS

Limitations on this doctrine, however, must be admitted. If the unit of production is very small, too small to have satisfactory banking connections, too small to have satisfactory marketing facilities, and too small to have adequate business direction, a certain degree of combination may very well be advantageous. Thus farmers, particularly those engaged in producing perishable products, may well find it desirable to form organizations of sufficient magnitude to enable them to hire a competent business representative and to enable them to ship their products in car-

load lots. It may even be worth their while and of advantage to the community as a whole for such an organization to have representatives of its own in central markets.

Laborers similarly are in general poor bargainers as individuals. Labor organization is essential if laborers are to be able to sell their perishable product, the day's work, on satisfactory terms. With labor organization, something of business ability can be introduced into the marketing of the laborer's product. With the accumulation of reserve funds by the unions, the laborer is placed in a position where he can finance his operations better and need not make a forced sale in an unsatisfactory market.

Such farmers' and laborers' combinations as are here commended need not and should not involve the element of monopoly. An organization of all the producers of fresh vegetables for winter consumption in the country covering Florida, Louisiana, Texas, and other places, might easily become pernicious. An organization of all the laborers of the country might easily become exceedingly tyrannical. In England, organized labor has gained such strength and coherence that it has been able to force upon the industry of England certain exceedingly vicious practices, particularly that of a systematic curtailment of output. Under the pressure of war needs, the English unions temporarily surrendered this practice, but they are now resuming it. We must avoid allowing this principle to go further in American labor organization. Mr. Schwab is giving sound advice to labor here, pointing out that the American business man twenty years ago operated on the same theory, seeking to form monopolistic combinations which would keep prices up by restricting output, but that the American business man has been forced by law, public sentiment, and his own good judgment to surrender these methods. He advises labor that it, too, must eliminate them.

The advantages of financial consolidation to facilitate marketing and to give better credit standing at the banks are limited. In the matter of borrowing, a well organized wholesale dry goods house, with half a million to a million dollars of capital and surplus, can probably borrow as cheaply at the biggest banks of New York as the United States Steel Corporation can. A house with $100,000 capital might have greater difficulty in establishing a satisfactory New York connection. But size need not go very far in most cases

to give the necessary prestige and stability and business ability which the banker demands.

COMBINATION VS. MIDDLEMAN IN FOREIGN TRADE

Is combination for marketing more necessary in foreign than in domestic trade? The extent to which it is necessary depends very greatly upon the quality and character of the middleman who might be employed in lieu of combination. Commission houses, jobbers and other middlemen provide all the marketing organization which many businesses need. In very many cases indeed, they supply much more satisfactory facilities than a combine could form for itself. Many London commission houses, for example, deal so justly, so uprightly, so intelligently with shippers from the other side of the earth, that those shippers would be ill-advised, as a rule, to establish independent selling agencies in London. So well established is the reputation of these London houses that a shipper in Java or China will regularly "consign" goods to them without prior arrangements. When the goods arrive in London, they will be taken by the London commission houses and sold at once if the market is right, or else made the basis of a loan. The goods may be of uneven quality, in which case the commission house will sort them into different grades, or it may even blend them with products from another country.

Apart from the commission house, there is the "export house." The export house buys and sells on its own account. Such houses may have their own ships as well as their selling agents abroad, and may even engage in banking business as well as in buying and selling commodities. They may have built up through a generation an intimate knowledge of credit conditions in a foreign country which a new combine could not get in a short time. They deal in many commodities, where the combine would deal in only one. They will have facilities for securing return cargos which the combine would lack, and so will have marked advantage over the combine in cheapness of transportation.[1]

There is one general consideration which should give us pause in contemplating great combinations, involving many millions of

[1] *See* the admirable paper by W. P. Goemann on "Coöperative Selling vs. the Middleman in the Upbuilding of our Foreign Commerce," *Economic World*, 1917.

capital, engaging in foreign trade. Individual traders, operating on a moderate scale, are unlikely to lead their governments into political friction with the governments of other countries. If, however, trade is to be organized on a vast scale, with a few great combinations representing England, America, Germany and France, seeking to dominate the various foreign markets, the possibilities of friction are very great. Before the war, England and America largely relied on the merchants' playing a comparatively lone hand, engaging in trade abroad on the same general basis as they engaged in trade at home. Germany, on the other hand, had organized great combinations closely affiliated with the banks and the government whose purposes were as much political as economic, and which indeed often subordinated profit to the prospect of extending German political influence. While this consideration should not lead us to look with disfavor on foreign trade combinations where such combinations clearly serve business ends of a legitimate sort and avoid the effort to secure monopoly, it should still make us cautious. We want a peaceful world after the war.

The Webb Act, authorizing combinations in foreign trade, subject to regulation by the Federal Trade Commission, does not contemplate that such combinations should give American producers monopolistic position in foreign countries. We have no intention of foisting on foreign countries the evils from which we have freed ourselves. None the less, it is probable that the Webb Act would not have been passed but for exaggerated fears of a trade war following German methods after the war, and our complete victory over Germany has removed most of the dangers which the Webb Act was designed to meet. Our Allies, likewise weakened by the war, would not be strong enough to drive us out of foreign markets if they chose, and if we meet them half way in the matter of fair policy in foreign trade, they will have no disposition to do so.

Organization under the new Webb Act has already gone so far that the best public service will consist, perhaps, not in opposing it, but in pointing out certain difficulties which it may encounter and mistakes which it should avoid. It differs from the old combination movement within the country in two important particulars. In the first place, it retains separate management, separate

control, and full competition among the units within the great domestic market. In the second place, though the Webb Act allows combination with respect to marketing of American products in the foreign fields, it still retains a fair field for such American producers as do not care to enter the combine in the foreign field, and it leaves competition between American producers and foreign producers in the foreign field. It amounts practically to a substitution of a producers' selling agency for the independent middleman. It does not involve the elimination of the middleman, if and when he is able to convince the American producer that he can perform services for him more efficiently than can the producers' selling agency. The opinion has been recently expressed by one of the leading export houses that so far as that house is concerned, it welcomes the new combinations, feeling that they will help advertise American products, and feeling sure also that the export house will get a considerable portion of the business even of the new combines.

Where, however, the combines are organized on a vast scale involving practically all the producers in America, their power in the foreign market may become so great that counter-combinations on the part of other countries are readily invited. In particular, it is probable, as seems already to have been the case in one important instance, that foreign combinations of *buyers* may be formed to meet the American combination of *sellers*. Where this is the case, a very significant change in the character of foreign commerce takes place. There is no longer a free, open market in which hundreds of buyers and sellers daily work out flexible adjustments of prices, but rather the determination of prices becomes a matter of semi-diplomatic negotiations between high contracting parties. If both sides are reasonable, this may work out in much the same way that the free competitive market would work out, but there is a grave danger that in critical periods deadlocks may come, leading to prolonged negotiations during which a cessation or great restriction of production and export take place.

On the other hand, where combinations under the Webb Act exist primarily for the purpose of enabling individual American producers to enter unfamiliar fields which they could not enter if obliged to bear the whole marketing and advertising expenses

alone, real good may come from them, and at all events we may watch the new experiment with interest.

Where Regulated Monopoly is Inevitable

Monopoly, subject to regulation, is necessary in some cases. Unregulated competition between two parallel railway lines easily leads to a cut-throat competition which ruins one or the other. Unless railroads are fully utilized—a condition which rarely happens except under such unusual conditions as the war has brought about—additional traffic on a given line increases earnings faster than costs, as we have seen. Under these conditions, each road of the two competing parallel lines has a great incentive to steal business away from its competitor and to cut rates and to give rebates in the process. Similarly, the limitation of space in a city street would make it undesirable that there should be parallel competing street car lines. Competing telephone companies in a given city are an unmitigated nuisance. In these and other cases, there is virtually concensus of opinion that monopoly of some kind under regulation is necessary.

Monopoly and Socialism

But it is to be observed that, where monopoly of this kind is established, even under public regulation, a strong political tendency arises for a further step. The movement becomes strong for *public ownership*, as is instanced in connection with the American railroad, telegraph, telephone and cable systems at the present time.

There is a moral to be drawn from this fact by those who believe in the system of private property and free enterprise. Regulation of business by the government easily leads to the demand for further regulation, and finally for public ownership. If American business generally should organize into large combinations subject to regulation by the Federal Trade Commission, it would make easier the task of the socialist in his advocacy of the "next step." By and large, the assertion may be safely made that those who oppose socialism must accept competition. Competition is after all a better regulator of business than the Federal Trade Commission. In the special cases instanced above of special public utilities, we reluctantly give it as inadequate or undesirable, but for the general field of business, it is the one sure principle that can promise progress, efficiency, reasonable

prices, and continued freedom from governmental regulation with the danger of ultimate government ownership.

Even for the railroads, the writer is convinced that private enterprise is far preferable to government ownership. In a country whose general spirit is that of competition, we may rely upon enough impetus from the general business field to prevent stagnation in railroading under private monopoly subject to government regulation. The danger of stagnation under government ownership is less easily eliminated. Private enterprise has two great advantages in connection with railroading over public ownership, which must be strongly stressed: (1) The check of the balance sheet. A government can afford to run railroads inefficiently because it can make up the deficits through taxation, but private enterprise cannot. (2) A government railroad is much more exposed to unreasonable demands by labor than is a private railroad. But neither of these points, nor other undoubted evils of government ownership, can make a sufficiently popular appeal to give us certainty that government ownership of railroads can be averted. The writer feels reasonably sure of his generalization that the defenders of private property and free enterprise must cling to the competitive principle as well, or else be unable to make adequate resistance to the socialist. Given competition, the present social order, even with its imperfections, is far better than any system which the socialist might propose to substitute for it.

Competition is a term which is not always understood in the same way. To many critics of the existing social order, competition appears as a dreadful nightmare, a bitter struggle for existence in which the weak and helpless are ruthlessly crowded out. They see in it merely the social manifestation of the Darwinian principle of the "survival of the fittest" of "nature red in tooth and claw." In point of fact, competition is not to be understood apart from what has been termed "the level of competition." Competition may take place with clubs, the stronger savage braining the weaker savage and taking his goods from him, but competition may also take place on a higher plane. A prize fight is a competition, but one subject to rules. The fighter must not hit below the belt, he must not use his teeth or his feet in the contest. Within the limits marked out by the rules, he may

exert himself to the utmost. War and diplomacy represent competitions subject to rules. A general may use heavy guns, as heavy as he can command; his men may shoot accurately; they may use the most powerful explosives; but they may not poison wells or fire upon a flag of truce. A diplomat may bargain shrewdly for his country, but he must not treat a solemn treaty as a scrap of paper. It may indeed be said that the greatest sin against civilization is hitting below the belt, and that the great war which we have just fought through to victory has been fought to vindicate that principle; that Germany, who regarded a solemn treaty as a scrap of paper, who poisoned wells and fired on hospitals, is an outcast against which the whole world has allied itself.

Similarly, in business competition, there is a social, moral and legal level of competition, enforced by trade practices, by public sentiment, and where need be by the law. Handicaps put equally on all competitors constitute a burden to none. If all are prohibited from employing unfair practices, none are handicapped. Unregulated competition may easily lead to sad conditions. Thus in the laundries of New York City some years since, women were working long hours in wet cellars filled with steam. Pneumonia and tuberculosis were frequently found among them. Humane men, employers of these women, asked to better the conditions, correctly replied that they were helpless; that if they incurred the expense necessary to improve the conditions, they would have to raise their prices, and that they could not raise their prices without losing their customers. A solution was found in a new arrangement whereby all were required to improve the conditions and pass on the costs of the improvement to the public. Numerous applications of the principle can be found. The contention that competition should be the regulator does not mean that there is no function for the state or for public opinion or for morality. The level of competition itself must be subject to constant study and correction. But the function of the state in these matters should be largely that of an umpire setting the rules, seeing that they are adhered to, determining the level, but leaving the active business man free to make his own plans and contracts without regulation within the sphere of what is considered legitimate business. As the state goes further than this, it hampers initiative and enterprise, and it paves the way for socialism.